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Executive Secretary

8/10/82

Date

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THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM 82-5678

DATE: 8-9-82 NUMBER: 077423CA DUE BY: 7L

SUBJECT: Cabinet Council on Economic Affairs - August 11 10:00 a.m. in Room 330 of the OEOB

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☑	☐
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
	☐	☐
	☐	☐

	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☑	☐
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☑
Wheeler	☐	☑
Kudlow	☐	☑
	☐	☐
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	☐	☐
	☐	☐
CCCT/Gunn	☐	☐
CCEA/Porter	☑	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: The Cabinet Council on Economic Affairs will meet on Wednesday, August 11, at 10:00 a.m. in Conference Room 330 of the Old Executive Office Bldg.

The agenda and papers are attached.

TREA has not reviewed. Processed IAW CIA TREA arrangement letter dtd 4/11/08.

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ATTACHMENTS

RETURN TO:

☐ **Craig L. Fuller**
Assistant to the President
for Cabinet Affairs
456-2823

☑ **Becky Norton Dunlop**
Director, Office of
Cabinet Affairs
456-2800

THE WHITE HOUSE

WASHINGTON

August 9, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the August 11 Meeting

The agenda and papers for the Wednesday, August 11 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 10:00 a.m. in Room 330 of the Old Executive Office Building.

The first agenda item is U.S. membership in the African Development Bank. The Council last reviewed this issue on July 1 and requested a paper for subsequent consideration. An issue paper reflecting the questions raised at the Council's previous discussion of this issue is attached.

One of the crucial questions involved in U.S. membership in the African Development Bank is the budget situation with respect to U.S. participation in Multilateral Development Banks in general. A short paper, "The Budget Problem in the Multilateral Development Banks," prepared by the Office of Management and Budget is attached.

The second agenda item is a review of the replenishment funding levels of the Inter-American Development Bank and the Asian Development Bank. The U.S. delegations to both negotiations need instructions for meetings in early September. A paper, prepared by the Department of the Treasury, reporting on the status of the negotiations and the budget impacts is attached. The Treasury package also includes a paper, requested by the Council, on "The Financial Condition of the African Development Bank."

Attachments

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THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

August 11, 1982

10:00 a.m.

Room 330

AGENDA

1. U.S. Membership in the African Development Bank (CM#270)

2. Multilateral Development Bank Funding (CM#179)

(CM#270)

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U.S. Membership in the African Development Bank

Issue

Should the U.S. join the African Development Bank (AFDB) later this year when membership in the bank is formally opened to nonregional countries?

I. Background

The AFDB was established in 1964 to make loans at near market terms for the economic and social development of its African members. The bank currently has 50 African member countries who have subscribed to over $2.9 billion in capital and have paid in more than $740 million. In its 15 years of operations, the bank has made loans totaling over $1.6 billion for projects primarily in agriculture and to build infrastructure.

The African Development Fund (AFDF) is the bank's concessional loan affiliate. The AFDF was formed in 1972 in accordance with an agreement among the AFDB and 16 nonregional countries. The U.S. has been a member of the AFDF since 1976 and is currently pledged to provide an annual contribution of $50 million in FY 1983, 1984, and 1985. Although the AFDB and the AFDF are separate financial and legal entities, a single staff serves both institutions.

Nonregional Membership in the AFDB

Opening the AFDB to nonregional membership has been a protracted and difficult process. In order to preserve the distinctly regional character of the bank, membership was originally restricted to African states. It soon became apparent that the limited resources of the bank's African members restricted the bank's lending programs and access to capital markets. Therefore, in May 1979, the Governors of the AFDB approved resolutions to allow nonregional countries to join the bank. The U.S. Government had participated actively in the negotiations leading to these resolutions and secured the largest share of the proposed nonregional portion of AFDB capital stock. Ratifying the resolutions expanding bank membership took more time than expected. Algeria, Libya, and Nigeria refused to ratify the necessary changes in the bank's charter. Not until Nigeria's change of position in May, 1982 was the AFDB charter changed to

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allow non-African membership. The necessary technical preparations to make shares of AFDB capital stock available should be completed by the end of this year. Nearly all of the concerned nonregional countries have expressed a willingness to join the bank as soon as membership to them is formally opened.

In 1979 the previous Administration agreed to join the AFDB, subject to Congressional approval. Early in 1981, believing that ratification of the charter amendments was imminent, the Reagan Administration obtained the legislation necessary for the U.S. to join the AFDB. Authorization for U.S. membership with a subscription of $360 million over five years, constituting 17 percent of the total nonregional subscriptions, was included in the FY 1982 Budget Reconciliation Bill. The first installment of the U.S. subscription to the AFDB, $18 million of paid-in capital and a program limitation of $54 million for callable capital, was included in the FY 1981 Supplemental Appropriations Bill. The federal budget currently contains no provisions for the remainder of the U.S. subscription in FY 1984 through FY 1987.

II. AFDB in the Broader Context of the Multilateral Development Banks

The U.S. remains a strong supporter of the multilateral development banks (MDBs). For FY 1983, the Administration has requested over $1.5 billion for the hard and soft loan facilities of the major multilateral banks. In proposing this commitment of resources, the Administration has sought to achieve three broad policy objectives:

1. The U.S. must maintain its role as the leader of the non-Communist world. The MDBs promote stability and economic development in countries which are important to the U.S.

2. The U.S. supports the preservation and growth of a market-oriented global economic and financial system through social and economic development. MDB activities strengthen the ability of LDCs to participate freely in the Western oriented international trade and finance system.

3. The U.S. has a strong humanitarian commitment. In promoting economic growth and through programs targeted to

the poorest people, the MDBs assist in alleviating poverty and improving material well-being in developing countries.

In a more operational sense, the U.S. has pursued three objectives in its day-to-day participation in the MDBs:

1. Advancing U.S. commercial interests by developing new trading opportunities.

2. Minimizing direct U.S. budget outlays through burden sharing arrangements and leveraging U.S. paid-in contributions. Leveraging is accomplished by generating other subscribers in response to U.S. subscriptions and by emphasizing the hard loan windows of the banks.

3. Improving the institutional efficiency of the MDBs. The U.S. influences MDB managements, in proportion to the U.S. subscription, to minimize administrative expenses and to place high quality loans.

Within this overall context, the AFDB plays an important role in U.S. foreign policy. Although other multilateral financial institutions have programs in Africa -- notably the IMF and the World Bank -- and the U.S. provides assistance through bilateral programs the AFDB is the only pan-African institution devoted to economic development financing. African countries are becoming increasingly important to the U.S. as raw material suppliers and because of the strategic location of certain African states in regions vital to U.S. interests. Also, the U.S. cannot afford to allow the growing Soviet presence, particularly as an arms supplier, to go unchallenged. In addition to loans for agriculture and infrastructure, the AFDB has advanced U.S. interests in providing humanitarian assistance to the region. The economic and financial problems of African states are increasing, and it would be difficult to envision a reduced role for the AFDB or the U.S. in addressing them. This does not imply that U.S. assistance, public or private, must be directed solely or even primarily through the AFDB.

Some question the ability of the AFDB to contribute significantly to U.S. goals for the MDBs. They make three principal points:

1. The AFDB provides an insignificant portion of the external resources to key countries in Africa (Egypt,

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Morocco, Tunisia, Kenya, Somalia, and Nigeria). In 1980 and 1981 the AFDB committed less than 5 percent of the resources pledged to these countries by the U.S. and the MDBs. In neither 1980 nor 1981 did AFDB commitments exceed eleven percent in any one of these countries.

2. The U.S. will have little actual influence over the lending policies of the bank. Contributing 17 percent of the one-third nonregional voting share, the U.S. will hold slightly less than 6 percent of the total voting shares. U.S. entry into the bank is still opposed by Libya and Algeria, and AFDB lending includes countries which the U.S. would not support.

3. The AFDB's cost of funds is likely to be so high that it will be difficult to develop qualifying projects, particularly among the poorest countries. If the AFDB is to improve its financial condition, its loan rate must increase. The AFDB intends to use the private capital market as a source of funds. Based on World Bank experience, the cost of capital from this source is high -- currently approximately 13 percent. This rate is very close to the average rate of return IDA has calculated for its development projects in sub-Saharan Africa.

Foreign Assistance and the U.S. Congress

Over the years, no country can approach the record of the American people in providing assistance to the developing world. However, in recent years, the Congress has found it increasingly difficult to sustain historic levels of foreign assistance. In part this turning away from foreign aid is the result of serious concerns about the effectiveness of U.S. foreign assistance in advancing U.S. foreign policy objectives, and in part it is the result of increasing budgetary pressures. The experience of the last two years in trying to curtail the growth of bloated domestic programs has intensified the concern about foreign aid spending.

The FY 1983 Administration request for foreign aid projects outlays of a little over $8 billion. This includes approximately $3.8 billion for security assistance and $4.3 billion for economic and financial assistance. There is a serious question whether Congress will appropriate levels close to the Administration requests. If not, the issue of whether or not to join

the AFDB must be placed in the broader context of what programs the Congress is willing to support and at what levels.

U.S. membership in the AFDB will require appropriations of $18 million in each of the four years, FY 1984 through FY 1987, and authorizations for up to $54 million in callable capital in each of those years. To date no MDB has found it necessary to call in this capital reserve. Because the date of formal membership in the AFDB has remained uncertain, no provision was made in the U.S. budget for paid-in or callable capital for FY 1984 through FY 1987. If we decide to join it may be necessary to find these funds within the spending ceilings already established for those years.

AFDB Financial and Management Problems

The AFDB is the least effective of the MDBs from an administrative and operational viewpoint. As a rule the staff of the AFDB has been drawn from the member countries, and compensation at the bank has precluded access to the highly trained and experienced manpower employed by the other MDBs. Some initial steps have been taken to improve the staff's quality, but much more needs to be done. The acceptance of nonregional members should have a beneficial effect on the composition of the staff. Top-level management at the AFDB is aware of the staff shortcomings and is committed to upgrading the staff.

More serious is the financial condition of the AFDB. Until reform measures were introduced recently, the financial condition of the bank had been growing worse as a result of three factors:

1. Member subscription arrearages resulting from depressed economic conditions in all member states;

2. Loan payment arrearages -- one third of 1981 loan payments were overdue at the end of the year -- reflecting the weakened financial positions of borrowing countries; and

3. Most importantly, the failure of the bank to increase lending rates.

Top-level management has recognized the seriousness of the bank's position and has taken initial steps to collect both sub-

scription and loan arrearages. The effective rate of interest on most loans has been raised to 10.5 percent. Although the bank is still committed to fund $950 million in loans at 8 to 8.5 percent, and the marginal borrowing rate for the bank is presently over 15 percent, the average cost of funds for the present is 10.5 percent. It is always conceivable that a call on callable capital could become necessary, since roughly half of the AFDB's borrowing countries are on the Department of the Treasury's Payment Interruption Watch List. However, the Treasury Department has carefully reviewed the question of whether or not the AFDB may need to call on a portion of its callable cpaital before the financial condition of the bank can be improved. Because the AFDB has made special efforts to open and retain lines of credit up to $1 billion, it is very unlikely that a call on callable capital would be necessary. The Treasury study (attached) supports this conclusion even if one makes the extreme assumption that half of the bank's loan portfolio were to default and nonregional countries were not to join the bank.

Further changes will be necessary to put the bank on a sound financial footing. The acceptance of nonregional members is seen as an opportunity to effect major changes both in the financial structure and the management procedures of the bank. It is of course important to establish that the acceptance of nonregional members not be seen as an infusion of new capital to sustain unprofitable practices of the past.

Prospects for U.S. Influence

If the U.S. joins, it would have 17 percent of the 1/3 nonregional voting share in addition to being the most important contributor to the African Development Fund, which is also managed by the Bank. An effective Executive Director chosen by the U.S. could significantly influence the workings of the Bank. In fact, the U.S. and other nonregional countries have already had an important impact on Bank policies. At the annual meeting in Lusaka last May, African Development Bank President Mung'omba promised a major improvement in financial management. The Bank has since approved and begun implementing a financial reform package. The Germans, Japanese, British and other donors strongly agree on the need to keep Bank management committed to the most recent reforms. Although the Africans will still hold 2/3 of the voting shares, enough African countries take a responsible view of the Bank that this should be possible, particularly since the Bank is seeking a bond rating to borrow in the capital markets.

III. Alternatives for CCEA Consideration

There are two alternatives for CCEA consideration:

1. Join the AFDB when membership to nonregional countries is offered formally later this year, or

2. Delay joining the AFDB when membership to nonregional countries is offered formally later this year, pending further improvement in the bank's financial condition.

Option 1: Join the AFDB when membership to nonregional countries is offered formally later this year.

Advantages

- The U.S. has already made a virtual commitment to join the African Development Bank.

- The AFDB is the only pan-African institution devoted to economic development financing.

- The African countries served by the AFDB are important to U.S. foreign policy interests.

- AFDB management has expressed a strong commitment to improving the financial position of the bank.

- The U.S. and other prospective nonregional members can better influence the future of the bank from the inside as members than from the outside.

Disadvantages

- The AFDB's financial position needs further improvement. Joining now will be seen as a commitment to salvage the bank in case of more serious financial trouble.

- Membership adds $18 million in outlays and $54 million in additional commitment in each year from FY 1984 through FY 1987 to the budget.

- U.S. leverage over the lending and management policies of the bank with roughly 6 percent of the vote is uncertain.

Option 2: Delay joining the AFDB when membership to nonregional countries is offered formally later this year, pending further improvement in the bank's financial condition.

Advantages

- o This position might increase U.S. leverage in effecting meaningful change in the bank's operations before the U.S. becomes a member.

- o Congress is more likely to be receptive to a very hard-nosed approach on the part of the Administration in negotiating U.S. terms and conditions of membership.

Disadvantages

- o Failure of the U.S. to be among the first nonregional members would be a sharp departure from the U.S. role and intentions to date and send a negative signal to African member states.

- o The U.S. could lose its leadership role in improving the operation of the bank.

The Budget Problem in the Multilateral Development Banks

-- Treasury has proposed funding 5 programs in 1984 and beyond, at a cost of $192 million per year. The budget planning figure provides only $100 million for new programs.

Program	Annual Amount
Inter-American Bank Ordinary Capital	60
(Callable Capital)	(1139)
IDB Fund for Special Operations	80
Asian Bank Ordinary Capital	14
(Callable Capital)	(260)
Private Sector Investment Corporation	20
African Bank Ordinary Capital	18
(Callable Capital)	(54)
Provided in budget for new programs	-100
NET BUDGET ADD-ON	92
(Callable Capital)	(1453)

-- In addition, it is likely that in 1983 the amounts available for the banks will be close to 1982 levels as determined by the continuing resolution formula. Even if a regular appropriation bill is ultimately enacted, amounts are not likely to exceed this level. As a result, $323 million would be cut from the 1983 request and, under international replenishment agreements, should be sought in 1984.

-- The net effect of these changes would be to raise the 1984 request $745 million above the 1983 continuing resolution level.

Budget Authority ($ millions)	1984
Planning Level	1543
C.R. Carry-Over	323
Net Program Add-ons	92
TOTAL	1959
1983 C.R. Level	1214
Excess: 1984 over 1983	745

-- Replenishment discussions in the International Finance Corporation could lead to an additional request as early as 1984, and a multilateral investment insurance scheme is also under discussion.

Multilateral Development Banks
($ in millions)

	1982	1983		1984			
	Est.	Req.	C.R.	Plan	Carry-Over	Additional Proposals	Total
World Bank Group							
World Bank	147	126	126	110	--	--	110
(Callable Capital)	(1688)	(1530)	(1530)	(1353)	(--)	(--)	(1353)
Int'l Development Association	700	945	700	1095	245	--	1340
Int'l Finance Corp.	14	--	--	--	--	--	--
Inter-American Development Bank							
Ordinary Capital	48	62	48	--	14	60	74
(Callable Capital)	(610)	(828)	(610)	(*)	(219)	(1139)	(1357)
Fund/Special Ops.	173	222	173	41 1/	49	80	170
Priv. Sec. Inv. Corp.	--	--	--	--	--	20	20
Asian Dev. Bank							
Ordinary Capital	5	.2	.2	--	--	14	14
(Callable Capital)	(43)	(2)	(2)	(*)	(--)	(260)	(260)
Asian Dev. Fund	116	132	116	147	16	--	163
African Dev. Bank							
Ordinary Capital	--	--	--	--	--	18	18
(Callable Capital)	(--)	(--)	(--)	(--)	(--)	(54)	(54)
African Dev. Fund	58	50	50	50	--	--	50
New Programs	--	--	--	100	--	-100	--
TOTAL PAID-IN (=BA)	1262	1537	1214	1543	323	92	1959
(Callable)	(2340)	(2361)	(2142)	(1353)*	(219)	(1453)	(3025)

* Amounts of callable capital contributions to the Asian and Inter-American Banks were not specified in the planning levels.

1/ The 1984 FSO amount shown is the carry-over from past unfunded pledges. No annual FSO level was specified in the planning ceilings, but annual payments are assumed from the $100 million provided for new programs.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

AUG 6 1982

MEMORANDUM FOR: THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Marc E. Leland
Assistant Secretary
International Affairs

SUBJECT: Multilateral Development Bank (MDB) Issues

It was agreed in 1981 that in preparing the FY 1984 and outyear budget figures for the Multilateral Development Banks no allocation would be made for paid-in capital for the Asian Development Bank General Capital Increase or the Inter-American Development Bank replenishment, and that no allocation would be made for U.S. subscriptions to the African Development Bank. The decision to exclude budget figures for paid-in capital was based on the belief that such exclusion would strengthen the position of the U.S. representative in negotiating zero paid-in capital. The African Development Bank decision was based on the fact that the charter amendments necessary to open the African Development Bank to non-regional members had been delayed by the refusal of Algeria, Nigeria, and Libya to ratify the amendments.

Negotiations of the ADB and IDB replenishments are now at a point where presentation of a formal U.S. position is critical to the timely completion of the negotiations. In particular, the IDB has scheduled a meeting for September 9-10 in Toronto where it hopes to make substantial progress towards reaching agreement on a replenishment. At this time it is clear that it will not be possible to reach agreement with other member countries of the ADB or the IDB on zero paid-in capital. These countries believe that paid-in capital is essential for the future of the institutions, not only as evidence of continued strong donor country support, but also as financial backing for the issuance of bonds in the international capital markets. In addition, consultations with Congress have shown that there is strong Congressional opposition to zero paid-in capital in these institutions.

Ratification of the African Development Bank (AFDB) charter amendments allowing non-regional membership was completed following Nigeria's approval of the amendment in May, 1982, and the Bank has asked for an indication of when the United States will be prepared to join. At its July 1 meeting the Council

considered the question of U.S. membership in the African Development Bank, and requested that an assessment be made of the likelihood of a call on AFDB callable capital. That analysis (Tab B) concluded that a call can be avoided, even under extremely pessimistic assumptions. A meeting of potential non-regional members will take place in Toronto on September 11, at which time the United States should be prepared to announce its intentions regarding U.S. membership.

We are seeking the advice and approval of the Cabinet Council for the U.S. representative in the ADB and IDB negotiations to seek agreement in the ADB and IDB replenishments as summarized in the table below. We also are seeking authority for U.S. membership in the African Development Bank. A memorandum requesting approval of the budget figures implied by the proposed U.S. positions and by U.S. membership in the African Development Bank will be sent to the Budget Review Board.

	Replenishment Size ($ billions)	U.S. Share (%)	Replenishment Period	Total U.S. Share ($ millions)	Maximum Annual U.S. Subscription/Contribution Paid-in ($ millions)	Callable ($ millions)
IDB	13.9	34.5	FY 84-87	4795.5	59.9	1138.9
FSO	0.8	40.0	FY 84-87	320.0	80.0	——
ADB	8.4	16.3	FY 84-88	1369.2	13.7	260.1
AFDB	2.1 1/	17.0	FY 84-87	359.7 2/	18.0	54.0
Total				6844.4	171.6	1453.0

1/ Non-regional portion of capital increase.

2/ The first installment of the U.S. subscription ($18 million paid-in and $54 million callable) was included in the FY 1981 Suplemental Appropriations Bill.

As additional background, a table of all MDB appropriations is attached (Attachment C).

Attachments

Multilateral Development Bank Issues

Introduction

The Administration's assessment of U.S. Participation in the Multilateral Development Banks in the 1980's, endorsed by the Council in January 1982, highlighted the importance of the MDBs, and strongly recommended future U.S. participation in these institutions. The assessment recommended a reduction in real terms in U.S. contributions to the soft-loan windows, but assumed the U.S. would retain its share -- and its leadership position -- in the hard-loan windows, hopefully on the basis of capital increases which did not require paid-in capital. In this context, the United States has been participating since January, 1982 in international negotiations of resource replenishments for the Inter-American Development Bank and the Asian Development Bank.

I. Inter-American Development Bank - Status of Negotiations

Negotiations to replenish IDB resources of both its capital window and its concessional window for the period 1983 to 1986 have been inconclusive, although a number of replenishment scenarios have been suggested. During the IDB annual meeting in March, several of the larger IDB borrowers (the Group A countries of Argentina, Brazil, and Mexico) proposed a $22.6 billion capital increase, which would permit the overall lending program to grow at an 18 percent nominal rate. The Group A proposal assumes that 7.5 percent of subscriptions will be paid-in.

The Canadians have proposed a replenishment that would permit a 15 percent nominal growth in the overall lending program for all but the largest borrowers, with the Group A countries capped at a total of $1.0 billion per year. All non-regional countries have expressed support for the Canadian proposal. Canada and all the non-regional countries strongly support a paid-in capital share of no less than 5 percent.

The United States has not yet presented a formal proposal, but the U.S. representative to the replenishment negotiations has suggested consideration of a scenario which would include a capital increase of approximately $10.6 billion, or an amount which would support a nominal growth in the lending program of about 12 percent to all but the Group A countries (these countries would remain capped at $750 million per year), and a paid-in capital share of around 2 percent.

We believe agreement could be reached on a replenishment which would support 15 percent growth in lending to all but the largest (Group A) borrowers, with 5 percent paid-in capital. Lending to Group A countries would be capped at the same nominal level as under the current replenishment, i.e., $750 million per year. This implies a total capital increase of approximately $13.9 billion, $695 million of which would be paid-in.

Regarding the Fund for Special Operations (FSO), the United States has suggested a replenishment of $500 million, compared to the current FSO replenishment of $1.75 billion. In an attempt to compensate for the low level of the U.S. proposal, both the Group A proposal and the Canadian proposal suggest the establishment of an Intermediate Financing Facility (IFF) which would subsidize interest rates on some portion of the capital lending program. Specifically, Group A has proposed an FSO replenishment of $184 million combined with a $632 million IFF. The Canadian proposal is comprised of $684 million for the FSO and $404 million for an IFF. However, support for an IFF appears to be waning in light of U.S. opposition.

Budget Impact

The size of the capital increase required in the IDB to support a given lending program will depend on the extent to which existing and new capital is leveraged (a number of possibilities for increasing the leverage are now under discussion). The Group A proposal, which assumes that usable callable capital is increased by the addition of Group A callable capital, implies an annual U.S. subscription of $1,949 million, $146 million of which would be paid-in capital, and $1,803 million of which would be callable capital. The Group A proposal also implies annual U.S. contributions of $18.4 million to the FSO and $63.2 million to an IFF. This compares to a current annual U.S. subscription of $51.5 million in paid-in capital, $636 million in callable capital, and $175 million in contributions to the FSO.

The Canadian proposal, based on slightly different callable capital assumptions from the Group A proposal, implies an annual U.S. subscription of $68 million in paid-in capital and $1,293 million in callable capital. The Canadian proposal also would require $40 million in annual U.S. contributions for the Intermediate Financing Facility, and $68 million for the FSO.

Based on some alternative assumptions about the leveraging of existing IDB resources, a capital increase of approximately $13.9 billion, of which $695 million (5 percent) would be paid-in capital, would be sufficient to finance 15 percent growth in lending to non-Group A countries. The annual U.S. subscription under this proposal would total approximately $1,200 million, $60 million in paid-in capital and $1,140 million in callable capital in four equal installments beginning in FY 1984.

We believe agreement could be reached on an FSO replenishment of $800 million, implying annual U.S. contributions of $80 million over the four year period (FY 84-87). Such a replenishment would continue to allow significant amounts of concessional lending to the poorest countries, such as Haiti and many of the other Caribbean Basin countries, while providing some FSO resources to other traditional FSO borrowers as they phase into total reliance on borrowing from the hard window.

II. Asian Development Bank (ADB) - Status of Negotiations

Negotiations for a General Capital Increase (GCI) have been underway in the Board of Directors since late 1980. ADB management has proposed an increase of $10.4 billion to support 20 percent annual growth in lending in nominal terms over the five year replenishment period (1983-1987), with a 10 percent share of paid-in capital, and the remainder callable capital. This proposal would provide for a 125 percent increase in the capital resources of the Bank. At the most recent discussion (May 20, 1982), the United States suggested that other member countries consider a scenario comprised of a capital increase of $7.0 - $7.4 billion, which would support up to 13.5 percent annual nominal growth in the lending program, and a paid-in capital share of one or two percent.

No other member countries have expressed support for the U.S. suggestion, with the majority supporting management's proposal. Only the United Kingdom and Canada have urged a growth in the lending program of less than 20 percent and, implicitly, a capital increase of less than $10.4 billion. No other countries have supported the suggestion of a 2 percent share or less of paid-in capital.

We believe that agreement could be reached on an $8.4 billion capital increase which includes a paid-in capital share of up to 5 percent, and which would support nominal growth in the lending program of 15 percent per annum. Agreement at such a level would avoid the risk of others reaching a consensus on a different (and larger) proposal, leaving us with a choice of either maintaining our share of an unacceptably large capital increase, or allowing our share, and our influence in the institution, to decline.

Budget Impact

Assuming no change in the U.S. share (16.3%), management's proposal implies a U.S. subscription of $339 million annually over a five year period (FY 84-88), $34 million of which would be paid-in and $305 million of which would be callable capital. By comparison, the current replenishment calls for the U.S. to provide $20.3 million annually in paid-in capital, and $183.2 million in callable capital.

As in the IDB, the U.S. is insisting in the replenishment negotiations on implementation of measures to increase the use of existing ADB resources, i.e. by increasing its use of convertible callable capital from 75 to 90 percent. This increase in the use of convertible callable capital means that an $8.4 billion GCI can support a 15 percent annual growth in the lending program in nominal terms. A capital increase of $8.4 billion, assuming 5 percent paid-in, translates into an annual U.S. subscription of $13.7 million for paid-in capital, and $260 million in callable

capital over the five year period (FY 84-88). This would be a nominal reduction in the U.S. paid-in subscription from the current replenishment.

III. The African Development Bank (AFDB)

At its July 1 meeting, the Council considered the question of U.S. membership in the African Development Bank and requested that an assessment be made of the likelihood of a call on AFDB callable capital. This analysis (Attachment B) concluded that a call can be avoided even under extremely pessimistic assumptions.

The budgetary costs of U.S. membership in the African Development Bank would be relatively modest. Joining the AFDB would entail annual requests of $18 million for paid-in capital and $54 million in program limitations for callable capital subscriptions in fiscal years 1984-87.

Authorization for U.S. membership and a U.S. subscription of $360 million was included in the FY 1982 Budget Reconciliation Bill (PL 97-135). The first installment of the U.S. subscription ($18 million paid-in and $54 million callable) was included in the FY 1981 Supplemental Appropriations Bill (PL 97-12). It was only when the opening of the Bank to non-regional membership was delayed that the Budget Review Board decided not to request funds for the Bank for FY 1983 and beyond.

As our previous paper on AFDB membership indicated (Attachment C) the financial situation of the AFDB, although serious, is not irreparable. Non-regional membership can only result in further positive action on both financial and administrative fronts. As members of the AFDB, we could effect necessary policy and administrative changes that we could not do as members of the African Development Fund only. We believe that the United States should become a member of the African Development Bank.

IV. Overall Budget Requirements

The overall budget requirements of replenishment agreements along the lines outlined above would be as follows:

Budget Authority
($ millions)

	FY 84	FY 85	FY 86	FY 87	FY 88	Total
IDB	59.94	59.94	59.94	59.94	---	239.76
FSO	80.00	80.00	80.00	80.00	---	320.00
ADB	13.69	13.69	13.69	13.69	13.69	68.45
AFDB	17.99	17.99	17.99	17.99	---	71.96
Total	171.62	171.62	171.62	171.62	13.69	700.17

The Financial Condition of the African Development Bank

Introduction

The possible entry of the United States to the African Development Bank was discussed at a recent meeting of the CCEA. At that meeting it was agreed that the one remaining outstanding issue was the question of the financial integrity of the institution. Because of the effect a call on callable capital would have on the other MDBs in the Congress and in the capital markets, it was deemed necessary that the likelihood of a call by the African Development Bank (AFDB) must be reexamined in detail. This paper examines the possibility of a call during the 1982-86 period and reviews other actions that will be necessary if the AFDB is to become a respected institution in the capital markets.

The AFDB faces problems similar to, and in many ways more severe than, those of many other financial institutions: problem assets; inadequate earnings on those assets, including a large volume of undisbursed loan commitments that cannot be funded profitably at today's interest rates; and a mismatch of the maturities of assets and liabilities. To these adverse factors must be added a comparative lack of staff capability.

The solvency of the institution, if recent trends and policies continue, has been questioned. The AFDB Board has recently adopted some policy changes which indicate both an awareness of and a willingness to address existing problems, that had not been previously apparent. Nevertheless, in an effort to examine the widest range of implications for U.S. membership in the Bank, Treasury has prepared a "Doomsday Scenario" entailing large scale defaults, in order to determine if the resulting liquidity squeeze would culminate in a call on callable capital. It appears that Management has caught the problems in time, and that a call can be avoided even under extraordinarily pessimistic assumptions.

The loan portfolio

The AFDB had $1399 million1/ in loan commitments at year-end 1981, of which $506 million is disbursed and outstanding and $892 million is undisbursed. The loans are earning an average of 8.5 percent, while the Bank's average borrowing cost is 11.5 percent. Loans made since year-end 1981, however, bear effective interest rates of 10.5 percent, roughly in line with the total cost of funds employed (including paid-in capital).

1/ The AFDB's accounts are expressed in Bank units of account, which are equivalent to the SDR, where 1 SDR equals $1.11. For convenience the paper shows figures in U.S. dollars converted at the above rate.

Principal and interest arrearages in 1981 were $12.5 million and $14.8 million respectively, double the level of the previous year. Approximately 25 percent of loans were late in payment of principal and interest to some degree, although a proportion of these arrearages could reflect technical difficulties rather than an inability or unwillingness to pay. Management has informed member countries that disbursements on existing loans are being halted, and no new loans will be made to countries in arrears.

Loans have been made to 45 of the Bank's 50 member countries. The 12 largest borrowers2/ account for 52 percent of the outstanding loans. Fifteen countries3/ that have either had recent reschedulings or are regarded as being possible candidates for rescheduling in the next few years account for 47 percent of the Bank's outstanding loans. The bulk of the arrearages are on loans to seven countries4/ holding 22 percent of the outstanding loans.

Because of the low level of disbursed loans ($506 million) compared with paid-in capital and reserves ($502 million), the Bank, from a capital adequacy position, could withstand large percentage write-offs of its present loan portfolio without endangering its capital position.

Write-offs are not expected, however, and would be outside the experience of the MDBs. Reschedulings, which are also outside the MDBs' experiences, are certainly more possible, although if this were to occur it could affect the IBRD as well if it also had loans outstanding to those countries. In the case of rescheduling, however, the loan would retain some residual value. The question remains whether the Bank could survive a major liquidity squeeze resulting from some large scale defaults without resorting to a call on callable capital.

Ability to fund existing indebtedness

The AFDB has a very ambitious lending program planned for the years 1982-86, that assumes non-regional participation effective January 1, 1983. The Bank plans to commit $4 billion, disburse $990 million, borrow an additional gross $1426 million or $1280 million net, and increase liquid assets by $832 million.

2/ Cameroon, Congo, Egypt, Ghana, Kenya, Liberia, Malawi, Morocco, Senegal, Togo, Tunisia, Zaire.

3/ Central Africa Republic, Ghana, Ivory Coast, Kenya, Liberia, Madagascar, Malawi, Senegal, Sierra Leone, Sudan, Tanzania, Togo, Uganda, Zambia, Zaire.

4/ Cameroon, Ghana, Sierra Leone, Sudan, Tanzania, Togo, and Uganda.

A critical factor in the Bank's proposed program will be its ability to borrow in the capital markets. As of December 31, 1981, the Bank had outstanding borrowings of $357 million, of which some $89 million was held by official sources and $269 million was held by commercial banks or public investors in Germany. The Bank also held $619 million in unused lines-of-credit, which has since been increased to over $1 billion. Most of the Bank's estimated borrowing needs for the forthcoming period are therefore already accounted for under these lines of credit.

Treasury has examined a "Doomsday scenario" under which the Bank suffers defaults on 50 percent of its loan portfolio during 1982, which continue for the whole of the 1982-86 period. In response, the Bank immediately ceases disbursement on loans to the defaulting countries, while maintaining new lending operations and receiving subscriptions based on the new GCI from the non-defaulting countries. In this case, Treasury estimates that:

-- The Bank would have gross and net borrowing needs over the 1982-86 period of $524 million and $378 million, respectively. These figures assume that liquidity would increase by $304 million, in line with the Bank's policy that liquidity be twice the current year's disbursements, and the non-regionals contribute $384 million in paid-in capital. Net borrowing needs excluding these funds required for this liquidity buildup would only be $74 million. (See table 1).

-- If the non-regionals were not to join during this period, gross borrowings would have to increase; by $908 million and net borrowings by $762 millon. These figures also include the $304 million buildup in liquidity; net borrowing needs above the $304 million required to fund the liquidity account would only be $458 million. (Obviously, if the non-regionals do not join the Bank other substantial changes in the lending program, not reflected here, would probably be necessary).

The increased borrowings needed to fund a reduced program in the face of massive defaults over the 1982-86 period appear to be well within the lines-of-credit with commercial banks already established by the AFDB, with or without non-regional participation, given a willingness by the Bank to cut-back operations in the face of difficulties. Accordingly, the recently instituted policies on arrearages and lending rates, if implemented properly, appear to make the likelihood of a call during the 1982-86 period extremely unlikely. Non-regional participation should assure such implementation.

This is not intended to imply that the AFDB is likely to attain the creditworthiness of the other MDBs during the period under question. Much remains to be done in terms of financial policies to enhance its stature and creditworthiness, and given the countries to which it lends, it can never reasonably be expected to be treated on a par with the World Bank. In particular, the Bank is likely to remain dependent on further infusions of paid-in capital well beyond the time that they have been phased-out or down to minimum levels in the other MDB's.

Further actions required

In order to assure the long-term financial integrity of the AFDB, and bring its creditworthiness as close as possible to the other MDBs a number of initiatives are required, including:

-- An increase in the lending rate and other financial changes to assure full coverage of current borrowing costs and improve the net income position. Bank staff, as evidenced by the recent five-year operational program document appear to agree with this position. However, when the lending rate was increased recently, it was to a level below average total borrowing costs (including low interest loans from governments that are unlikely to be renewed at their present rates); the Bank therefore continues to rely on new subscriptions of paid-in capital to subsidize the lending rate.

-- Reduction in the difference between the average maturities of the Bank's borrowings and its loans to reduce refunding risks. This would involve a combination of a cut in the maturity of Bank loans, which realistically will be difficult given its effect on the debt service payments of the already hard-pressed countries, together with the Bank borrowing long term at fixed rates in the world's capital markets. The latter which is more realistic, undoubtedly requires a bond-rating. The employment of a first class U.S. investment banking house as an adviser is required to accomplish this goal. We have received indications that the Bank is considering hiring First Boston Corporation as a consultant; we will attempt to influence the terms of reference of any studies undertaken.

-- Concentration on projects with high economic and financial rates of return. The AFDB will be lending to countries with relatively low creditworthiness -- eighteen of the present

forty-five AFDB borrowers borrow from the World Bank solely on IDA terms and only six solely on IBRD terms -- while the AFDB's borrowing costs and hence its lending rate should logically be higher than the IBRD's. Since projects with high rates of return are not conspicuously abundant in Africa, this argues for very modest lending by the AFDB, with the bulk of lending to Africa being on concessional terms through IDA and the AFDF.

-- The AFDB should move to pass the exchange risk on its borrowings to its members, instead of absorbing this itself. It is anomalous that the weakest MDB should be the only one taking such a risk on its own account. Action has been promised on this item before, but so far Management has not changed its policy.

-- Finally, none of the above are likely without a substantial upgrading of the quality of the staff. The hiring of non-regional staff members should raise the level of staff expertise. This will undoubtedly require a more generous compensation package than presently provided, which itself will drive up administrative expenses and necessary lending rates unless other economies can be effected. The other MDBs and member governments should be encouraged to provide necessary technical assistance including staff on secondment to the AFDB.

cc: Walsh, OMB
Pearson, AID
McMullen, State

Attachment

Table 1

AFDB Cash Flows (1982-1986)

(millions of dollars: 1 BUA = $1.11)

	1982	1983	1984	1985	1986
CASH OUTFLOW					
Disbursements	69	101	129	163	208
Repayment of Debt	44	14	16	16	56
ADF Encashment of Notes	1	5	3	-	-
Total	114	120	148	179	264
CASH INFLOW					
Subscriptions:					
Regionals	12	21	21	19	9
Non-regionals	-	96	96	96	96
Repayment on Loans	18	21	35	47	60
Total	30	138	152	162	165
Gap to be funded:					
Cash flow	(84)	(18)	(4)	(17)	(99)
Means of funding:					
Liquid Assets b/f	222	202	258	326	416
Liquidity Available	138	184	256	309	317
Additional borrowings	64	74	70	107	209
Liquid Assets c/f	202	258	326	416	526
Average Liquid Assets	212	230	292	371	471

Attachment B

ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 29, 1982

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: MARC E. LELAND
ASSISTANT SECRETARY
INTERNATIONAL AFFAIRS

SUBJECT: U.S. Membership in the African Development Bank

The amendments to the charter of the African Development Bank (AFDB) to allow membership by non-regional countries were ratified during the Bank's annual meeting in May. It is anticipated that by December the final steps will have been taken to open formally the Bank to non-African members. Therefore, a final decision on U.S. membership in the Bank is needed. In making that decision the financial and institutional problems of the African Development Bank as well as the budgetary implications of membership should be considered. In order to provide the background for a decision on U.S. membership, a brief history of the AFDB and U.S. involvement in it is set out below. Following the history is a discussion of the problems facing the Bank and the budgetary implications of U.S. membership.

The AFDB and U.S. Involvement

The African Development Bank was established in 1964 to make loans on near-market terms for the economic and social development of its African members individually and through regional cooperation. The AFDB's concessional loan affiliate, the African Development Fund (AFDF), was formed in 1972 pursuant to an agreement between the AFDB and 16 non-regional states. The African Development Fund is a separate and distinct financial and legal entity from the African Development Bank with a separate Board of Directors. However, the management and staff are the same for both institutions. The U.S. has been a member of the AFDF since 1976 and is currently pledged to provide an annual contribution of $50 million.

The Bank currently has 50 African member countries who have subscribed to over $2.9 billion in capital and paid-in more than $740 million. The AFDB is the only pan-African institution devoted to the financing of development. In its 15 years of operations the Bank has lent over $1.6 billion, primarily for projects aimed at strengthening the agricultural sector and financing needed infrastructure.

Now that the AFDB charter has been changed to allow non-African members, the increase in capital needs to be triggered so that there are shares of AFDB stock for the non-regionals to subscribe. It is anticipated that this will occur in the last quarter of this year so that non-regional members can formally join the Bank by late 1982 or early 1983. All the other non-regional countries either are ready or expect to be ready to join the AFDB by December. Nearly all the non-regionals have expressed a willingness to join the AFDB as soon as the Bank is formally open to them.

AFDB's Institutional Problems

From an administrative and operational viewpoint, the African Development Bank Group is less effective and efficient than the other multilateral development banks. This is not surprising given the relatively low salaries paid the staff of the AFDB and the fact that the staff is drawn entirely from regional member countries -- the Bank simply does not have the access to the highly trained, experienced manpower the other MDBs do. AFDB Management is aware of the administrative and operational weakness of the Bank and has been taking measures to strengthen the institution and its staff. However, substantial further improvement will be needed in the AFDB. It is anticipated that hiring of non-regional staff members will help raise the level of staff expertise and full non-regional participation in AFDB policy making will result in changes which will foster administrative improvements.

AFDB's Financial Problems

The financial condition of the Bank has deteriorated since Treasury first began to monitor the situation two years ago. The single most important factor in the decline has been the lack of Bank action to increase lending rates. This has been compounded by increasing loan and subscription arrearages and poor performance in the Bank's investment account. The biggest problem is that the AFDB is committed to funding about $930 million in loan commitments carrying interest rates of 8 to 8.5 percent while it would currently have to draw on lines of credit bearing interest rates of 18-19 percent to do so.

The greatest concern is that if present trends continued, it is possible to imagine that an actual call on callable capital could become necessary. Fortunately, Management has acknowledged the difficult financial future facing the Bank and proposed steps that, if fully implemented, would begin to stem the deterioration in the AFDB's financial condition. The Board of Directors has agreed to adopt Management's proposals for financial policy changes, and has increased the effective rate of interest on most loans to 10.5 percent. Management has moved to collect both loan and subscription arrearages. While these actions are a good first step, further changes will be needed to put the Bank on a sound financial footing.

Budgetary Implications of U.S. Membership

When the opening of the AFDB to membership by non-regional countries was delayed, it was decided that funds for the Bank would not be requested for FY 1983 and no provision would be made for subscriptions in the out-years. No decision was made to request rescission of the amounts already appropriated.

An affirmative decision on U.S. membership in the AFDB would require that an appropriation be requested in FY 1984 and that AFDB subscriptions be provided for in the budget planning levels for FY 1985 through FY 1987. Membership would entail budget outlays totaling $90 million; $18 million per year over the FY 1983-87 period. Annual requests would be $18 million for paid-in capital and $54 million in program limitations for callable capital subscriptions in fiscal years 1984-87.

The budgetary costs of membership will be modest although it can be argued that even those amounts will be difficult given current budgetary circumstances. As far as the AFDB's financial situation is concerned, the situation is serious but shows positive signs. The AFDB has already started to take steps to improve the Bank's financial condition and non-regional membership can only result in further positive action on both financial and administrative fronts.

As a member of the AFDB the U.S. could effect necessary policy and administrative changes that we cannot do as a member of only the AFDF. Membership in the Bank, i.e., the "hard loan window" of the institution, could be seen as a natural corollary to our participation in the "soft loan window", the African Development Fund. In addition, membership in the Bank would be consistent with the MDB Assessment conclusions in that AFDB lending is concentrated on poor countries.

ATTACHMENT C

Multilateral Development Bank Appropriations
$ millions

	FY 1982 Actual	FY 1983 Request	FY 1984 Request: Planning Level	FY 1984 Request: Additional Proposed Replenishments	FY 1984 Request: Revised Total
IBRD					
Paid-in	146.9	126.0	109.7	—	109.7
Callable	<1,687.7>	<1,530.2>	<1,353.2>	< — >	<1,353.2>
Total	1,834.6	1,656.3	1,462.9	—	1,462.9
IDA	700.0	945.0	1,095.0	—	1,095.0
IFC	14.4	—	—	—	—
IDB					
Paid-in	48.1	62.4	—	59.9	59.9
Callable	<609.6>	<828.1>	< — >*	<1,138.9>	<1,138.9>
Total	657.6	890.6	—	1,198.9	1,198.9
FSO/PSI	173.1	221.7	141.1**	—	141.1**
ADB					
Paid-in	4.7	.3	—	13.7	13.7
Callable	<42.6>	<2.2>	< — >*	<260.1>	<260.1>
Total	47.3	2.5	—	273.8	273.8
ADF	116.1	131.6	147.1	—	147.1
AFDB					
Paid-in	—	—	—	18.0	18.0
Callable	—	—	< — >	<54.0>	<54.0>
Total	—	—	—	72.0	72.0
AFDF	58.3	50.0	50.0	—	50.0
Total MDBs	3,601.7	3,897.7	2,896.1	1,544.6	4,440.7
Budget Authority	1,261.7	1,537.0	1,542.9	91.6	1,634.5
Callable Capital	<2,339.9>	<2,360.7>	<1,353.2>*	<1,453.0>	<2,806.2>

Columns may not add due to rounding.

* Excludes hypothetical amounts of callable capital used for planning purposes.

** An undetermined portion (estimated to be $20 million to, perhaps, $50 million) will fund a private sector initiative in the IDB.